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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

Jordan's Financial Outlook

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1971

INTELLIGENCE MEMORANDUM

JORDAN'S FINANCIAL OUTLOOK

Introduction

1. Jordan must soon make some hard financial decisions. Both the budget and the balance of payments are now in worse shape than they were in 1970, when large deficits were incurred. The budget problem in particular needs immediate attention to prevent a crisis. This memorandum describes the present budgetary difficulties, the prospects for additional foreign aid, and the options open to Jordan if requested aid is not received.

Discussion

Background

2. Government spending is the driving force in Jordan's⁽¹⁾ economy. Government outlays this year⁽²⁾ are equal to roughly three-fourths of the East Bank's gross national product (GNP).⁽³⁾ With expenditures so high relative to output, Amman clearly cannot raise enough domestic revenue to meet its needs. Thus, Jordan continues to depend upon foreign grant aid to supply a major portion of its total revenue requirements.

Recent Budget Trends

3. Jordan's domestic finances since the 1967 Arab-Israeli war have been characterized by rapidly rising expenditures accompanied by a much slower growth of tax revenues. Moreover, total government revenues in 1969 and 1970 suffered from declining foreign aid.⁽⁴⁾ Jordan ran a budget surplus

1. Unless otherwise specified, the term Jordan refers to the territory under the de facto control of the Government of Jordan. Since the June 1967 war with Israel, this includes only territory east of the Jordan River.

2. Jordan's fiscal year coincides with the calendar year.

3. GNP as reported by the Jordanian government normally includes an estimate of West Bank production.

4. Budget figures include budget support assistance and extraordinary grants, but foreign credits and loans are excluded, as are expenditures of funds from these sources.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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in 1967 as the sum of tax receipts and foreign aid (largely grant aid) exceeded expenditures, but in the three following years, respective budget deficits of \$24 million, \$34 million, and \$46 million were incurred (see Table 1).

4. Government expenditures increased about 60% between 1966 and 1970, to \$224 million.⁽⁵⁾ Most of the increase went to defense – outlays for which reached \$106 million in 1970, nearly double the 1966 level. Defense spending would have been even greater in 1970 except that a payment on a US arms contract was postponed, dropping outlays below the previous year's level. The sharp rise in defense spending since the 1967 war reflected not only defense needs but also pressure from Arab donors to have their aid used for defense purposes. Recurring civilian expenditures also rose more than 30% between 1966 and 1970, with the largest increases going for public security, pensions, and compensation of government employees.

5. Domestic revenues and foreign aid were 45% greater in 1970 than in 1966 – \$178 million versus \$122 million – while 1970 expenditures were some 60% greater. The increase in revenue was registered despite a decline in 1970 of some \$20 million, with both domestic and foreign receipts falling below 1969 levels. The 1970 decline followed respective increases of \$57 million, \$7 million, and \$13 million in the three preceding years.

6. Domestic revenues rose about 30% between 1967 and 1969, but dropped sharply in 1970 to below the 1966 level. The loss of the West Bank during the June 1967 war caused domestic revenues to fall sharply, but they rose again after the war as a result of economic growth, a boost in customs duties in 1969, particularly on consumer durables, and increased profit on government equity in economic enterprises. The upward trend continued into the first half of 1970, when receipts were 8% above a year earlier, but fighting with the fedayeen then slowed economic activity, drastically reducing customs receipts and profit on government holdings, with the result that for the entire year domestic receipts were 8% below the 1969 level.

7. Since the Arab-Israeli war, foreign aid has provided about 55% of total annual revenue. This compares with a pre-war share of about 30%. Before the war, the United States and Great Britain were the major suppliers of grant aid. From 1967 through 1970, however, almost all grant aid came

5. Expenditures are divided into three main categories – defense, recurring civilian, and development. The armed forces budget, which does not include grant aid in the form of equipment, comprises 45% of the total, recurring civilian expenditures 30%, and development expenditures 25%. Nearly all of the increase is for military and so-called development spending.

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Table 1
Government Budget a/

	Million US \$					
	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
Revenue	121.6	178.5	185.2	198.0	177.7	180.7
Domestic	<u>86.9</u>	<u>72.0</u>	<u>73.8</u>	<u>92.9</u>	<u>85.1</u>	<u>100.0</u>
Customs and excises	42.8	34.6	36.6	46.8	38.9	
Direct taxes	12.0	8.5	8.7	7.0	11.4	
Licenses and fees	10.6	8.0	8.1	10.6	9.6	
Posts, telegraph, and telephone	4.6	3.6	2.8	3.0	3.1	
Interest and profits <u>b/</u>	7.6	5.8	8.1	13.0	13.7	
Miscellaneous	9.3	11.5	9.5	12.5	8.4	
Foreign aid (budget support)	<u>34.7</u>	<u>106.5</u>	<u>111.4</u>	<u>105.1</u>	<u>92.6</u>	<u>80.7</u>
Arab aid (only Saudi Arabia in 1971)	--	86.6	105.9	105.1	92.6	41.5
US aid	31.1	17.2	5.5	--	--	32.5
Other	3.6	2.7	--	--	--	6.7
Expenditures	139.2	172.2	209.3	231.6	223.9	257.0
Recurring civilian	54.9	57.3	61.7	66.5	72.3	76.5
Civil services	45.7	48.2	52.6	56.1	60.1	63.3
Public security	9.2	9.1	9.1	10.4	12.2	13.2
Armed forces	54.3	67.7	98.5	116.1	105.6	116.8
Development	30.0	47.2	49.1	49.0	46.0	63.7
Deficit <u>c/</u>	17.6	-6.3	24.1	33.6	46.2	76.3
Domestic borrowing	0	0	0	23.5	11.8	33.6
Carryover <u>d/</u>	+17.6	-6.3	+24.1	+10.1	+34.4	+42.7

a. The government's fiscal year now coincides with the calendar year. Until 1966 the fiscal year ran from 1 April to 31 March. The actual 1966 budget ran for only nine months to implement this change. In this memorandum, however, 1966 budget data have been calculated on a twelve-month basis - 1 January to 31 December.

b. Including loan repayments.

c. A minus sign signifies a surplus.

d. A plus sign signifies unfinanced deficit; a minus sign signifies a surplus.

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from Kuwait, Libya, and Saudi Arabia under the terms of the September 1967 Khartoum Agreement. From September 1967 to September 1970, when heavy fighting developed with the fedayeen, Arab aid averaged about \$105 million annually. After that flareup, however, Kuwait and Libya suspended their payments of \$39 million and \$25 million, respectively. Kuwait resumed payments in December 1970 only to suspend them again in January 1971. For all of 1970, Jordan's Khartoum aid came to about \$93 million.

8. The need for foreign aid to help meet Jordan's budget deficit derives from the close link between government spending and the international balance of payments. Jordan's economy is relatively primitive, and productive capacity is very small in relation to aggregate demand, which is inflated by government spending. Since the economy has little ability to respond to increased demand by raising output, an increase in government spending not balanced by an increase in tax collections or borrowing from the public is bound to boost imports. Indeed, many goods purchased by the government itself must be imported. Since 1969, however, sizable increases in the money supply resulting from government deficit financing have in large measure been held by the public in idle balances, without pushing up prices. The public apparently has willingly increased its cash holdings as a precautionary measure in the troubled political situation. To the extent that future increases in the money supply are held in idle balances, the negative impact of further deficit financing on the balance of payments will be minimized. Amman fears, however, that willingness to add to cash holdings will decline or disappear. If this happens, then unless substantial new sources of foreign exchange are found as growth of the domestic money supply continues, as imports increase, foreign exchange reserves will be drawn down seriously leading to a fall in confidence, and possibly to a major capital flight. During the first eight months of 1971, foreign exchange reserves declined some 4% to \$245 million (equivalent to about 12 months' imports). Meanwhile the money supply increased about \$40 million to \$335 million. Foreign exchange reserves are expected to show a large decline in the final quarter of the year because of payments for military equipment, a repayment of military debt, a repayment on a Kuwait development loan, and a payment for civilian passenger aircraft. These outlays alone will amount to roughly \$20 million.

The 1971 Budget

9. The 1971 budget estimated by the Central Bank in September of this year is about 11% larger than in 1969, the previous record high (see Table 1). Expenditures are expected to reach \$257 million -- almost 15% above 1970 and about 85% more than in 1966, the last full year before the Arab-Israeli war. Total revenue also is projected to increase by

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less than 2% above the 1970 level. The September projections put 1971 domestic receipts at about \$100 million – some 18% above the 1970 level, but the foreign budget support component of revenue is expected to drop. As a result, a record budget deficit of \$76 million is projected.

Expenditures

10. Defense spending is now projected at about \$117 million – about \$11 million more than in 1970 and about \$1 million more than in 1969 (see Table 2). The original budget accepted by Parliament in April 1971 had allocated only \$110 million for defense. Of this, \$20 million was to be spent only if Kuwaiti and Libyan subsidies were received. Most of the spending that was to be financed by the Kuwaiti and Libyan subsidies, however, actually has been committed and will have to be carried out. The problem of containing military expenditures has been aggravated by the July fighting with the fedayeen, which raised defense spending \$3 million. Costs also have been raised further by maintaining manpower levels above those allowed for originally in the budget. A US government economic team that visited Jordan in late June 1971 discussed military spending with both civilian and military experts and concluded that the higher military spending was consistent with the force structure and modernization plans already approved by the United States. The team concluded that a major reduction in military spending would force a stretch-out in the modernization program that would jeopardize morale and combat effectiveness. Amman, therefore, would be reluctant to pressure the armed forces to make major expenditure reductions.

11. Recent budget estimates also place recurring civilian expenditures somewhat higher than originally estimated. The budget submitted to Parliament in April anticipated a rise of only about 2% in 1971 to \$73.8 million. By mid-year this estimate had been raised to about \$77.3 million, a 7% increase over 1970. The government is attempting to reduce civilian spending and has made cuts thus far of \$1.4 million in proposed outlays. However, this reduction has been partly offset by a \$0.6 million rise in public security costs, resulting primarily from fedayeen sabotage activities. As of October the Central Bank projected 1971 recurring civilian expenditures at \$76.5 million – only \$0.8 million less than projected at mid-year (see Table 3).

12. The development budget includes much more than the name implies. Most of the nonmilitary costs of the 1967 war and subsequent fighting with the fedayeen are included within the four main sections of

Table 2
Jordan's Armed Forces Budget

	Million US \$				
	1968	1969	1970	1971	1971 Foreign Exchange Portion
Army	<u>90.5</u>	<u>106.3</u>	<u>90.5</u>	<u>103.3</u>	<u>29.2</u>
Salaries and allowances	39.2	42.0	53.2	61.6	1.8
Quartermaster	5.8	5.7	8.4	9.2	2.7
Ordnance	5.3	2.8	5.6	9.0	8.8
Maintenance	1.4	1.2	4.2	7.1	6.4
Communication	0.3	0.3	1.1	1.3	1.2
Engineer	1.2	0.9	1.4	2.6	0.6
Equipment purchases and debt repayments a/	35.5	48.7	12.7	7.3	7.3
Other	1.8	4.7	3.9	2.2	0.4
Expenses resulting from July 1971 fighting with fedayeen				3.0	N.A.
Air force	<u>8.0</u>	<u>9.8</u>	<u>15.1</u>	<u>13.5</u>	<u>8.8</u>
Total	98.5	116.1	105.6	116.8	38.0

a. Excluding grant aid of military equipment.

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Table 3
Recurring Civilian Budget

	Million US \$			
	1968	1969	1970 <u>a/</u>	1971 <u>a/</u>
Public security	9.1	10.4	12.2	13.2
Administration	20.8	22.4	24.2	22.0
Social services	22.6	24.4	29.3	29.2
Education	14.1	15.5	19.5	18.8
Health	6.0	6.1	5.7	6.2
Other	2.5	2.8	4.1	4.2
Economic services	9.2	9.3	10.1	10.4
Agriculture	2.7	2.8	2.0	2.3
Communications and transport	5.0	5.0	3.6	3.5
Other	1.5	1.5	4.5	4.6
<i>Original budget</i>	61.7	66.5	75.8	74.8
<i>Revisions</i>	--	--	-3.5	+1.7
<i>Total</i>	61.7	66.5	72.3	76.5

a. The effect of the revision on individual categories is not known.

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this budget -- projects, debt servicing,⁽⁶⁾ contributions and subsidies,⁽⁷⁾ and emergency payments.⁽⁸⁾

13. Development budget expenditures increased greatly in 1971 because of fighting between the army and fedayeen in September 1970 and again in July 1971. According to Central Bank projections, these expenditures will approximate \$64 million in 1971 (see Table 4), compared with some \$46 million in 1970. Of the total spending labeled "development", about half probably will be spent for actual development projects and servicing of foreign development loans and the rest for extraordinary (war-related) expenses. In 1970, about \$20 million of the total \$46 million in the development budget was spent for projects and servicing of development loans and about \$25 million for war-related expenditures. Even this distinction between actual development spending and war-related spending is misleading as some of the development projects in this year's budget are rehabilitative rather than completely new projects. The government believes, and probably rightly, that rehabilitation of war-damaged installations often will have a greater positive effect on economic growth than new development projects.

Table 4

1971 Development Budget

	Million US \$
Projects	24
Debt servicing	20 <u>a/</u>
Contributions and subsidies	4
Emergency	16
<i>Total</i>	<i>64</i>

a. Excludes \$7.3 million owed to the United States which is included in the defense budget.

6. Military debt service was transferred to the development budget this year, but is retained in the defense budget in this memorandum for purposes of continuity. Domestic debt service has been carried in the development budget since 1970.

7. Primarily payments to companies for losses of income incurred as a result of the 1967 war or subsequent conflicts.

8. Primarily compensation to persons who have suffered property damage or financial loss as a result of the 1967 war or subsequent conflicts.

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SECRETRevenues

14. Total annual revenue was projected in September by the Central Bank to increase by less than 2% during 1971 to about \$181 million despite an expected decline in foreign budget support of \$12 million. An increase in domestic revenue of some 18% is projected. Although domestic revenue is being bolstered by increased tax rates and improved collection methods, the projection may be somewhat optimistic. At the time the projection was made, an early opening of the borders with both Syria and Iraq was expected, with an accompanying renewal of economic activity. Although the Iraqi border is now open and some goods are allowed to be moved through Syria, the border problem is still a brake on economic activity and tax collections.

15. If no additional budget support is received, foreign grant aid will fall from about \$93 million in 1970 to about \$81 million this year. Saudi Arabia is expected to provide \$41.5 million of this total, the United States \$32.5 million (another \$2.5 million in emergency relief provided by the United States has not been included in the budget), Abu Dhabi \$4.2 million, and other contributors about \$2.5 million. The prospects for additional Arab budget support aid during 1971 are dim. Libya is not likely to resume budget support in the foreseeable future. Kuwait may resume monthly aid payments at the previous annual rate of \$39 million, depending primarily on Jordan-fedayeen relations, but in any case there have been no indications that this will occur before the end of the year. Additional aid from one or more of the Persian Gulf sheikdoms is possible but cannot be counted on and, in any event, would not be large. The United States thus appears to be the principal potential source of substantial additional budget support in 1971.

16. In September the Central Bank revised its annual domestic revenue estimate from \$94 million to about \$100 million. Through August, \$62 million had been collected. Some \$12 million is expected in December from profits of the Central Bank and corporations in which the government has an interest. The remaining \$26 million (\$6.5 million a month for four months) may not all be collected, but any shortfall should be small.

The Deficit

17. The Jordan budget is an obligations budget; hence the \$76 million budget deficit is the difference between authorizations and current receipts. An obligations budget differs from a cash budget because of year-to-year variations in carryovers of obligations and unspent funds.

18. In the case of Jordan, the actual cash deficit for 1971 will be \$86 million, \$10 million more than the obligations budget (see Table 5).

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Table 5

**Potential Reduction
of the 1971 Cash Deficit**

	Million US \$
Total estimated cash deficit	86
Measures taken to date (domestic borrowing)	-34
Unfinanced cash deficit	52
Potential additional measures	
Further domestic borrowing	-5 to -10
Reducing government spending	-10
Increasing obligation carryover	-1.5 to -20
Total potential additional measures	-30 to -40
<i>Remaining unfinanced cash deficit</i>	<i>12 to 22</i>

About \$36 million of 1970 obligations are being paid in 1971, but this is partly offset by a \$16 million cash carryover and a planned carryover of some \$10 million in obligations into 1972. To cover the cash deficit, Jordan already has borrowed \$34 million, leaving a need for about \$52 million.

19. The government essentially has three options for covering the projected deficit without outside help - postponing the payment of obligations (increasing the carryover in 1972), increasing domestic borrowing, and eliminating certain obligations. The government probably will have to exercise all three options to cover the cash deficit.

20. The obligation carryover into 1972 probably could be increased by another \$15 million to \$20 million. The carryover is achieved basically in three ways: by carrying the 1971 purchase authority into 1972 for some goods that normally would be purchased this year; by making purchases in 1971 but not paying the bills until 1972; and by paying the bills from funds in special accounts in the Central Bank such as deposits of municipalities and then repaying these accounts after the beginning of the year. The potential for these devices is limited, however, and they merely postpone the day of reckoning.

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21. Increasing the level of domestic borrowing also creates problems. There are statutory limits on issuing treasury bills and bonds, and the level of outstanding obligations is now relatively close to these limits. Although statutes can be changed, the government is worried about the psychological impact that an increase in the debt ceiling would have upon the business community and the public generally. During 1970 the government raised the ceiling for treasury bills from 15% of the value of currency in circulation to 25%, and it fears that another hike in the ceiling this soon would raise serious doubts about the financial soundness of the government. Amman also fears the economic effects of the further increases in the money supply that would result from increased borrowing. Whether the money is borrowed from commercial banks or the Central Bank makes little difference, as the commercial banks have large excess reserves. The non-banking public is not a significant market for government securities. The Governor of the Central Bank stated in October that the possibility of capital flight and aggravated balance-of-payments problems was too great to allow a substantial increase in domestic borrowing. The government thus is reluctant to increase such borrowing by more than \$5 million to \$10 million; although if additional foreign aid is not forthcoming, it will have no other choice.

22. The potential for cutting 1971 expenditures is very limited and probably does not exceed \$10 million. Jordan already is in the fourth quarter of its fiscal year, and most of its expenditures for this year already have been made or committed. About 45% of spending is for defense. A substantial reduction there is considered unwise in the light of present fedayeen sabotage activity and tense relations with Syria and Iraq. Furthermore, about \$14 million of fourth quarter military expenses is debt service payments, and these apparently cannot be deferred. The government has reduced some expenditures in the recurring civilian budget, but in its view large cuts here are economically, politically, and socially undesirable. Most of the estimated \$10 million in spending cuts possible probably would have to be in so-called emergency expenditures in the development budget, such as compensation payments.

23. By increasing the obligation carryover into 1972 by \$15 million to \$20 million, increasing domestic borrowing by \$5 million to \$10 million, and reducing government spending by about \$10 million, the government could reduce the unfinanced portion of the deficit by \$30 million to \$40 million, leaving about \$12 million to \$22 million of the deficit to be financed by additional foreign aid. If Jordan does not receive additional budget support aid to cover the remaining portion of the deficit, the government probably will have to further increase domestic borrowing with the hope that a loss in confidence in the dinar will not materialize.

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SECRETThe 1972 Budget

24. The 1972 budget also projects a large gap between domestic revenue and total expenditures. Although domestic revenue is projected to increase by about 12% - on the basis of a projected increase in economic activity - compared to an increase in expenditures of 2%, the gap of about \$150 million will remain. (For a comparison of the 1971 and 1972 budgets, see Table 6.) While an increase in economic activity will increase domestic revenues, it will also result in a more rapid decline in foreign exchange reserves as imports rise. Jordan expects to finance part of the anticipated budget deficit through some \$75 million in foreign budget support, of which \$30 million is expected from, although not yet committed by, the United States. The remaining \$75 million - if not financed by additional foreign assistance - probably will force greatly increased domestic borrowing, curtailment of expenditures, or both.

Table 6
The 1971 and 1972 Budgets

	Million US \$	
	<u>1971 ^{a/}</u>	<u>1972</u>
Expenditures	<u>257.0</u>	<u>262</u>
Civil services	63.3	67
Public security	13.2	14
Armed forces	116.8	111
Development	63.7	70
Revenue	<u>180.7</u>	<u>187</u>
Foreign	80.7	75
Domestic	100.0	112
Deficit	76.3	75

a. The fiscal year coincides with the calendar year.

25. The first half of 1972 probably will be financially more difficult than 1971. Most carried-over obligations, which may reach \$30 million, will come due in the first half of 1972. Amman will have difficulty financing these obligations, in addition to 1972 obligations, as domestic revenue is

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expected to average only some \$9 million a month. Even if the United States were to provide more budget support to Jordan in US fiscal year 1973, funds would not be available before 1 July 1972. The restoration of Khartoum aid is possible in the case of Kuwait but unlikely in that of Libya.

Conclusions

26. Jordan's financial plight, which has been deteriorating steadily since 1969, may be fast approaching a crisis. The government has not yet funded the 1971 budget deficit, and the outlook for 1972 is for another, perhaps even larger, deficit. Jordan cannot safely finance its remaining 1971 commitments and projected 1972 expenditures without increases in foreign aid. If additional US aid is not received, Jordan could drastically cut expenditures (including a major reduction in military spending); expand domestic borrowing; or possibly make concessions to the fedayeen to restore now suspended Arab grant aid.⁽⁹⁾

27. Jordan would find it difficult to cut expenditures substantially because they are predominantly military, and the government believes it needs strong military forces at this time. If additional foreign aid is not received, the government almost certainly will increase domestic borrowing, thereby further inflating an already excessive money supply. The resulting rise in purchasing power would increase imports and cause a sharp decline in foreign exchange reserves. Up to now, increases in the money supply have not caused a major increase in imports, because unstable political conditions have discouraged business and consumer spending. However, with the fedayeen largely destroyed as a military force, more stable conditions are likely and the rate of spending for both consumption and investment may rise sharply, thus greatly increasing imports and reducing reserves. Since foreign exchange reserves are still very large (about one year's imports), such a drain could theoretically continue for a long time. But unless there were a reasonable expectation that enough additional foreign aid would be forthcoming in the next year to stop, or at least slow, the reserve loss, Jordanians would begin to anticipate the imposition of exchange and import controls. Accelerated conversion of dinars into goods and foreign exchange would then occur, and a crisis would be brought to a head. If the government did impose effective controls -- thereby curtailing the supply of goods -- the result would be rapid inflation within Jordan.

9. Although discussions are now being held in Jidda to formulate an agreement between Amman and the fedayeen, Amman is so far willing to agree to a return of fedayeen force only in small numbers and if they are under the control of the Jordan army.

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